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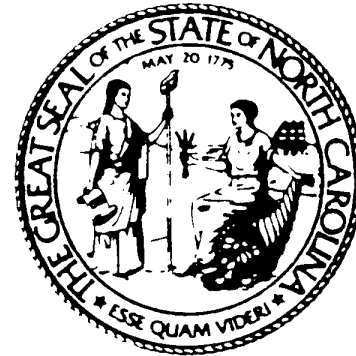
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**NORTH CAROLINA
GENERAL ASSEMBLY
GOVERNMENT PERFORMANCE
AUDIT COMMITTEE**

**PERFORMANCE AUDIT
OF PERSONNEL SYSTEMS**

**Final Report
December 1992**

TRARY

December 18, 1992

The Honorable Daniel T. Blue, Jr.
Speaker of the House

The Honorable Henson P. Barnes
President Pro Tempore

Members, Government Performance Audit Committee

This report presents the results of our performance audit of the State of North Carolina's personnel function as identified in the table of contents. Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

Purpose

The State of North Carolina's single most important asset is its employees. Our performance audit looked at the personnel system's procedures, processes, practices and effectiveness to ascertain if they are aligned with the State's purpose and mission and to recommend areas with the most potential for improvement for study in Phase II of the performance audit.

Background

As of 1991, the State funded approximately 212,000 positions (including 118,000 local public school and community college positions that are not within the scope of the audit). The payroll and benefits costs associated with these positions was \$3.8 billion in 1991. The State presently has 4,891 classifications or more than twice the average of other states. The last comprehensive update of the classification system was in 1949.

Results in brief

The State is not applying its current human resource related efforts in a comprehensive, forward-looking and cost effective manner. The State has major weaknesses in its human resource management practices, its classification system and compensation and the employee benefits programs. Also inequities in compensation and benefits exist between the branches of government.

The Honorable Daniel T. Blue, Jr.
The Honorable Henson P. Barnes
Members, Government Performance Audit Committee
December 18, 1992

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The State's compensation philosophy, embodied in how the State delivers compensation to its employees, is weighted heavily toward "cost of living" and longevity and is outdated in comparison to common and contemporary practices of other private and public employers.

Recommendations The State needs to improve some of its basic human resource management activities. It should decentralize its personnel practices within a policy framework that ensures coordination, cost effectiveness and a human perspective. A comprehensive strategy needs to be developed that identifies employee skill gaps and training curriculums to close the gaps. Position qualifications should be developed and only position qualified persons be hired.

The State should develop a new classification and compensation system. It should shift its compensation philosophy from rewarding employees for years of service to how well they meet service goals.

The State should eliminate longevity pay, institute a pay-for-performance plan and institute standard retirement criteria. It should implement a preferred provider organization program and better manage catastrophic health care costs.

Agency response The Office of Personnel Management indicated in its response that it disagreed with selected findings and recommendations.

This report is intended for the information of the Government Performance Audit Committee and the North Carolina Legislature. The report is a matter of public record and its distribution is not limited.

Very truly yours,

KPMG Peat Marwick

**STATE OF NORTH CAROLINA PERFORMANCE
AUDIT OF PERSONNEL
REPORT**

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EXECUTIVE SUMMARY

The objectives of this performance audit were to:

- Determine the effectiveness of the personnel system in attracting, retaining, motivating, and developing the State's workforce
- Assess if the State personnel function utilizes fundamental human resource management practices
- Assess if personnel processes, tools, and procedures are aligned with the purpose and mission of North Carolina State government
- Recommend specific issues and elements of the personnel system that appear to hold the most potential for improvement for in-depth analysis in Phase II

The North Carolina statewide government personnel systems under review in this performance audit comprise all three branches of State government. As of 1991, the State funded approximately 212,000 positions including 118,000 local public school and community college positions that are not within the scope of the audit.

Findings and recommendations

The results of the audit clearly demonstrate that the State of North Carolina needs to improve some of its fundamental human resource management activities and is not applying its current human resource-related efforts in a comprehensive, forward-looking, and cost-effective manner. The current personnel practices have resulted in the State **not** being able to effectively use funds appropriated for rewarding, motivating, developing, and ensuring the well-being of its workforce.

For the State to carry out its program and deliver citizen resources efficiently and effectively, it must maintain a skilled, experienced, and motivated workforce. State salaries and benefits represent one of its largest recurring expenditures--\$3.8 billion in 1991. The major weaknesses that North Carolina needs to resolve are organized and presented in the following areas:

- Human resource management practices
- Classification system and compensation
- Employee benefits
- Inequities in compensation and benefits

While the recommendations contained in this report require investments in the State's personnel system, the costs will be offset by long-term savings and are necessary if the State is to meet the challenges of the next decade.

Human resource management practices

Today's fiscal and economic trends and the size of the State government's investment in its workforce demand a contemporary approach to managing its human resources that achieves significant gains in efficiency and effectiveness. Successful management of the human resource function can result in increased employee morale, motivation, and empowerment of employees, which ultimately results in better service to the public.

The effectiveness of North Carolina's statewide personnel function should be improved. There are significant weaknesses in its current philosophy, organizational structure, and operations. The following recommendations address the most significant weaknesses in the State's practice of human resource management.

Recommendations

- The State should decentralize its personnel practices as much as feasible and affordable, but within a statewide policy framework that ensures coordination and a statewide human resource perspective. Legislation that was enacted in 1991 decentralized aspects of the State personnel functions to the agencies but failed to provide the necessary oversight to ensure policy coordination and attainment of economies of scale. Agency personnel activities should focus on the day-to-day operations and administration of personnel functions (e.g., hiring, terminations, classification, and general administration). However, these activities need to be supported by OSP in the areas of policy development, oversight, technical assistance, training coordination, statewide reporting, and to ensure the integrity of the classification and compensation system.
- State managers and employees should be trained to effectively use the performance evaluation process. The State's performance management system, if administered correctly, should provide the State government with an effective tool to communicate, document, manage, and motivate employees. Eighty-three percent of fiscal year 1991's eligible employees who underwent evaluation were rated "exceeds expectations," which is skewed so highly that it renders the performance evaluation ineffective. It is critical that the evaluation process be used as a tool for managers to effectively manage employees and be integrated with a contemporary pay-for-performance philosophy. It should not be viewed as merely a means to determine performance increases.
- The State needs to develop a comprehensive strategy that identifies and provides the appropriate training and development courses to its employees. The Office of State Personnel (OSP) needs to expand its current mission and practices to ensure that State training needs are comprehensively identified, planned, coordinated, and evaluated.

OSP should work with individual agencies to identify their training needs, courses being offered, and how economies of scale can be realized among State agencies. Through this process, OSP should develop a system to monitor statewide training and development costs. The monitoring of such costs potentially can be accomplished through the State budgeting process.

- The General Assembly should create a formal human resource management program to resolve the significant weaknesses in its personnel practices. The legislative personnel function is missing seven of thirteen basic principles that should be present in any sound personnel function.
- To eliminate the perception and reality of patronage on State personnel practices, the General Assembly should pass legislation specifying that it is State policy to hire candidates based on their qualifications and without regard to political affiliation. The legislation also should require OSP and State agencies to update their personnel policies and procedures to implement this new policy and establish associated controls. Further, legislation should require applicable agency supervisors and hiring managers to sign a certification that a hiring decision was made in accordance with State and agency personnel policies not on the basis of patronage.
- The State Personnel Commission should define the professional qualifications that the State Personnel Director and agency personnel directors should have. The recommended qualifications should be provided to the Governor for his use in evaluating and selecting the State Personnel Director. Agency personnel directors should be selected by the agency head through a competitive selection process based on the education and experience guidelines recommended by the State Personnel Commission.

Classification and compensation

A classification, or job grade system, is a system by which jobs are classified and grouped according to a series of predetermined wage classes. Successive grades require increasing amounts of job responsibility, skill, knowledge, ability, and/or other factors selected to compare jobs. Theoretically, the number of classifications should be sufficient to distinguish significant differences among jobs but not so great as to make the distinction between two adjoining classes insignificant. Our analysis of North Carolina's classification and compensation system determined that it has not had a comprehensive update since 1949 and currently has 4,891 classifications -- more than twice the average (i.e., 1,955) of the other 49 states. The State's average number of positions per job classification is 15, less than the average of all the other states and one-half the size of comparable states (i.e., states with more than 65,000 classified employees). The classification system *does not* use commonly accepted practices for determining salary structures, allow for progression of jobs within job families, promote career growth, and/or allow for salary growth other than through promotions, which leads to excessive layers of middle management.

The State's compensation philosophy, embodied in how the State delivers compensation to its employees, is weighted heavily toward "cost of living" and longevity and is outdated in comparison to common and contemporary practices of other private and public employers. The following recommendations summarize the most significant recommendations that address weaknesses in the State's compensation and classification practices.

Recommendations

- The State should conduct a classification and compensation study to determine which jobs are currently paid below, at, or above the competitive market. The State should develop and implement a new classification and compensation system that is consistent with contemporary compensation philosophy and allows for:
 - Consolidation of titles within classes and more generic job titles. This would be a means of achieving greater flexibility in assigning staff to tasks, while providing greater career mobility for employees.
 - Dual career tracks that provide employees with greater opportunities for vertical growth without becoming managers. With a dual career track, an employee can choose to stay on a technical track without being penalized in salary. If an employee is qualified to move into a managerial path, then that avenue will exist as well.
- The State needs to shift its compensation philosophy away from rewarding employees for their years of service to rewarding employees for how well they meet or exceed performance goals. For the State to more effectively utilize its compensation funds, the longevity program should be eliminated. *The yearly \$30 million savings from elimination of longevity pay should be used to fund performance increases.* This report also presents several options for phasing out the longevity program, but these are significantly less desirable because they do not provide sufficient savings to enable the State to fund an effective pay-for-performance program.
- For the State to appropriately reward employees for their performance, it should allow performance increases to be awarded for satisfactory performance. As discussed earlier, the State needs to tie its performance evaluation process to a pay-for-performance system. The State's grievance procedures discourage managers from evaluating employees "at" or "below" expectations because managers want to avoid the grievance process.
- Continue monitoring EEO protected class compensation and performance increases as well as hiring, promotion, demotion, and separation to ensure the system is not used to discriminate against employees.

Employee benefits

As of December 31, 1991, the average cost of an employee's benefits is nearly one-half of the employee's salary (i.e., 43 percent). The most rapidly increasing portion of employee benefits is the health benefits area. The State expenditures for medical care increased \$260 million in the last eight years, from \$95 million in 1983 to \$355 million in 1991. The following summary recommendations address the most significant weaknesses in the State's employee benefits practices.

Recommendations

- The State's employee medical benefits programs should be more cost-effective. The State should implement a Preferred Provider Organization (PPO) program or redesign its plan to increase the utilization of lower cost providers. *This can be expected to save the State approximately \$10 million annually* in addition to the \$20 million savings the State expects to realize from its recently established Preferred Provider Hospital Plan.
- The State should implement a program to better manage catastrophic costs. If the State were to implement an expanded catastrophic care detection and prevention program, *the State's medical plan could realize average annual savings of approximately \$150 million over the next five years*. The savings would phase in over a three-year period. These savings are net of implementation costs and derive from lowering the overall claim level. The lower claim level would result from the use of certain preventive measures and early diagnosis of manageable illnesses to preclude more costly intensive, leading-edge medical treatment for the same condition in later stages. Additionally, the medical plan's annual rate of increase would be reduced.
- The State should develop a strategy to retain dependents in the indemnity plan. Employees and retirees are dropping dependent coverage under the plan, which threatens its viability. Savings in the short-term are not expected with a change in the methodology, but a change is needed to maintain the viability of the medical program.
- The State should examine the legality of its practice of overfunding retiree and employee coverage. It currently subsidizes dependent coverage from reserves generated from this overfunding. The current contribution practice circumvents the intent of State law that dependents of employees and retirees are eligible for coverage only on a fully contributory basis.

Inequities in compensation and benefits

Judicial (elected and appointed positions) and General Assembly employees are eligible to receive longevity payments five years before executive branch employees and their payment schedule is much higher than the executive branch.

In the General Assembly, temporary employees who work during "short" and "long" sessions are immediately eligible for both retirement and health benefits. Temporary employees in the executive and judicial branches must work at least 30 hours per week, nine months of the year to be eligible for such benefits. General Assembly temporary employees also receive annual leave benefits and holidays after completing 60 months of service with the General Assembly. No other temporary employees in State government are provided these leave benefits.

Retirement service requirements and allowances are inconsistent across the branches. The State does not contribute to any employee 401(k) plans except for law enforcement officers. In addition, certain State-employed law enforcement officers are provided a separation allowance. No other group of employees receives a separation allowance.

The following recommendations highlight and summarize the most significant recommendations that address weaknesses in the State's employee benefit practices.

Recommendations

- The State should resolve the existing inequities in employees' compensation and benefits among the branches. The State should take the following actions to resolve these inequities:
 - Eliminate longevity pay
 - Institute a pay-for-performance philosophy
 - Institute standard retirement service criteria
- Temporary employees who perform like duties should be treated equally. Temporary employee benefits within the General Assembly should be revised to conform to the executive and judicial branches, or the executive and judicial branches should provide benefits equal to the General Assembly.
- The State should analyze all post-retirement benefits provided to various employee groups such as:
 - Pension plan
 - 401(k) plan
 - Severance allowance